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NASSCOM-EVEREST INDIA BPO STUDY

Roadmap 2012 - Capitalizing on
the Expanding BPO Landscape

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Executive Summary

India is at the forefront of the rapidly evolving Business Process Offshoring (BPO¹) market and is well established as a 'destination of choice'. Having grown manifold in size and matured in terms of service delivery capability and footprint over the past decade, the Indian BPO industry is now at an inflexion point – and faces a unique opportunity to enhance its role as a full-service, value-adding partner. There is significant headroom in the addressable BPO opportunity for buyers² and providers, and there are sizeable untapped opportunities across a wide spectrum of segments. Also, Indian BPO industry is favourably positioned to benefit from its established delivery capabilities, which bear a key influence on buyers' decision to expand their global sourcing exposure. Over the next five years, the right choices by stakeholders of the Indian BPO industry could effect a fivefold growth. The aspired target is aggressive, but it is achievable, and will bring huge payoffs to India's economy, employment and role in the global marketplace.

This study is a comprehensive fact-based view of capabilities, opportunities, and growth imperatives for the Indian BPO industry that will allow for focussed decision-making by all stakeholders – providers (third-party vendors and captives), buyers, NASSCOM and the Government.

Evolution to date

Growing at more than 35 percent over the past three years, BPO is the fastest growing segment of the overall offshore market³, and is currently estimated at US\$ 26-29 billion. While labour arbitrage has been a key driver for this growth, other factors such as access to talent, service quality, productivity, and time-to-market have gained importance.

The Indian BPO industry's growth and increasing maturity is reflected across multiple dimensions. In just over a decade, the industry has grown to reach nearly US\$ 11 billion⁴ in export revenues, employs more than 700,000 people, and accounts for more than 35 percent of the worldwide BPO market. This growth has been driven by 1) accelerated adoption by buyers of different sizes, from across industry verticals and geographies, and 2) rapidly evolving supply-side maturity across service segments. This is reflected in widening service portfolio, increased scope of services, greater penetration across vertical and geographic markets served, evolution of business and engagement models, and development of global delivery capabilities by the Indian BPO industry.

Most horizontal BPO⁵ segments (e.g., Customer Interaction and Support⁶, Finance & Accounting, Human Resources, Procurement Services, and Knowledge Services) have matured significantly and account for more than 70 percent of the Indian BPO industry. While Customer Interaction & Support

¹Throughout this report, BPO stands for Business Process Offshoring

²Including customers using third-party vendors and parent organizations of offshore captive entities

³Overall offshore market (including ITO and BPO) is estimated at US\$ 70-76 billion in 2007

⁴FY2008(E) export revenues - US\$ 10.9 billion

⁵Refers to BPO offerings that are reasonably similar across verticals

⁶Refers to the set of services relating to customer relationship management (CRM) including general query handling, service support, and sales and marketing services

(CIS) and Finance & Accounting (F&A) have been the dominant horizontal market segments, other service segments like Knowledge Services are increasingly becoming important and continue to drive market maturity. Many horizontal services are now demanded and offered across verticals – Everest's full-service index for the aggregate industry shows providers offer CIS, F&A and Knowledge Services across multiple verticals. In addition, both buyers and providers increasingly cover end-to-end services within each horizontal.

Another dimension of increased maturity of the industry is reflected in the growing importance of vertical-specific processes⁷. More than 25 percent of the Indian BPO market today consists of delivering functions and processes that are specific to a particular industry or vertical. In response to evolving buyer needs, providers have expanded their service footprint into core vertical-specific processes and are developing vertical specialization to increase breadth and depth of service delivery. As an example, our analysis shows that more than 50 percent of providers servicing Banking, Capital Markets and Insurance verticals have developed credible vertical specialization.

Further, the buyer (i.e. customer) profile of the industry shows increased diversification in terms of geography and size. Buyers from the UK, Continental Europe and Asia Pacific are increasingly offshoring delivery of business processes to India. Similarly, there is increased awareness and adoption amongst mid-sized and small buyers. In addition, the domestic Business Process Outsourcing market⁸ has also grown rapidly and is expected to reach about US\$ 1.6 billion by FY2008.

The provider landscape has also witnessed significant changes. In addition to establishing captive BPO centers, buyers now have a substantially large choice of third-party vendors to engage. In addition, several hybrid sourcing models like build-operate-transfer and virtual captives are also being used. The market is witnessing increased merger and acquisition (M&A) activity, as providers are looking to build scale and acquire new capabilities rapidly, particularly to increase geographic reach and acquire key service segment capabilities. Efforts are also underway to deliver value beyond cost savings and sustain high growth levels through increased use of tools and technologies, adoption of standards and best practices, and leveraging a global delivery model. The delivery footprint of the Indian BPO industry now extends to over 75 cities across 25 countries outside India. Within India, the delivery footprint of the BPO industry now extends to more than 30 cities across the country, and covers many Tier- 2/3 cities.

Future market opportunity

The achievements to date of Indian BPO industry are impressive. However, there is significant headroom to tap the addressable market opportunity from exports and from serving the domestic market. A bottom-up analysis shows a total export BPO market opportunity of US\$ 220-280 billion by 2012. The domestic Business Process Outsourcing market provides an additional US\$ 15-20 billion opportunity for the industry by 2012.

⁷ Refers to BPO services that require a high degree of vertical-specific knowledge

⁸ Business Process Outsourcing within India

The addressable market opportunity for Indian BPO industry shows that traditional areas of focus will continue to be large, but several other areas also have significant untapped potential for buyers and providers alike.

- **Market opportunity by verticals:** There is a large market opportunity not only for established industry verticals like Banking, Insurance and Manufacturing, but also for buyers and providers in many other emerging verticals. The Banking & Capital Markets, Insurance⁹ and Manufacturing verticals together constitute almost 70 percent (US\$ 160-190 billion) of the total US\$ 220-280 billion export market opportunity over the next five years. However, emerging verticals such as Technology, Telecom and Travel & Transportation verticals also provide opportunities in excess US\$ 10 billion by 2012. Other verticals such as Media & Publishing, Pharmaceuticals & Life Sciences, and Energy & Utilities too represent significant untapped opportunity.
- **Market opportunity by type of services:** Another way to look at the total export market opportunity is by type of services demanded – vertical-specific BPO services¹⁰ and horizontal BPO services.¹¹ Over the next five years, vertical-specific BPO services provide larger market opportunity (60 percent; US\$ 145-175 billion) compared to horizontal BPO services. Horizontal BPO services, which currently account for a greater share of services offshored to India, also provide a significant addressable market opportunity – a total of US\$ 75-105 billion spread across traditionally mature areas like CIS and F&A as well as emerging segments like HR, Knowledge Services, and Procurement Services.
- **Market opportunity by nature of work:** Buyers and providers need to expand their relationships into middle-office and front-office services, which together represent an opportunity in excess of US\$ 100 billion by 2012. However, back-office processes are expected to remain the largest opportunity areas over the next five years (providing more than 50 percent of the overall market opportunity). Back-office opportunities extend beyond traditional SG&A (e.g., F&A, HR) functions; services such as transaction processing activities in Banking and Capital Markets, investment operations in Capital Markets, supply chain and logistics support for the Manufacturing, Retail, and Travel industries are some examples of high-potential back-office services.
- **Market opportunity by source geography:** There is significant BPO opportunity for buyers and providers across geographic markets. While North America is expected to contribute roughly 70 percent of the total market opportunity for the Indian BPO industry, both providers and buyers should increasingly look at exploiting opportunities in the UK, Continental Europe and Asia Pacific. English-language based business processes from these geographies represent a huge market opportunity of US\$ 45-75 billion by 2012. Furthermore, domestic Business Process Outsourcing market (in verticals such as, Banking, Retail, Insurance, Media, Telecom, and Government) provides an additional US\$ 15-20 billion opportunity for the industry.

It is possible for Indian BPO providers to maximise the available market opportunity by developing a stronger nearshore presence, strengthening language and cultural capabilities, and developing distinctive value propositions.

⁹Includes Life & Pension, Property & Casualty and Health

¹⁰Refers to BPO services that require a high degree of vertical-specific knowledge

¹¹Refers to BPO services that are reasonably similar across verticals


Considerations for future growth

Efforts being undertaken by the Indian BPO industry will enable it to grow rapidly in the future. Continuing on current growth momentum could help the Indian BPO industry reach about US\$ 30 billion in export revenues by 2012. However, comparing past growth trends with the significant future market opportunity, the Indian BPO industry can set itself a stretch target of US\$ 50 billion (that is, approximately five times its present size) in export revenues by 2012. A fivefold growth in the Indian BPO market will add nearly 2.5 percent directly to India's GDP from exports earnings and provide direct employment to about 2 million people. This will also spur growth in smaller Tier - 2/3 cities to enable the sixfold growth in the number of delivery centers that will be required to support the stretch target for the industry. Also, it is important to note that secondary impact of the Indian BPO industry's growth on employment in related service industries and consumer spending is likely to be multiple times as compared to the direct impact.

In order to capture a significant part of the available opportunity, various stakeholders will need to manage multiple internal and external considerations: 1) supply-side constraints such as talent and infrastructure, 2) emerging competition from other offshore destinations, 3) threat to sustainability of Indian BPO industry's cost advantage and economic value proposition, and 4) evolving buyer expectations that require up-shifting of providers' value propositions. Further, fulfilling these expectations will require providers to make specific choices and trade-offs in terms of capabilities and investments.

The future growth of the Indian BPO industry will put significant constraints on the supply side. From a people perspective, capturing a fivefold growth will put pressure on talent availability at all levels. While the number of people required to support impending growth are available, unless the current focus on 'ready-to-eat' talent is altered, the future growth may lead to a shortage of 0.8-1.2 million entry-level graduates by 2012. This shortage may become further accentuated on account of competition for resources from domestic industries such as Retail, Insurance, Telecom, and Banking, as well as from additional requirements to support growth in domestic BPO business. Middle-management personnel with domain experience, largely sourced from the domestic industry, will also be in short supply. Sector-specific skill shortages (specialized skill categories for vertical-specific processes such as actuaries for Insurance BPO) are also likely to emerge. Additionally, a significant part of the fresh, entry-level pool is difficult to access, due to geographic distribution of employable talent. Tier - 2/3 cities in India will have to meet approximately 50 percent of the additional talent requirements. This will necessitate creation of physical and social infrastructure in these cities, which needs to be facilitated by various stakeholders.

While India is best equipped to capitalise on the available opportunities, these opportunities are not lost to other offshore destinations. A number of offshore / nearshore BPO destinations are emerging as viable options for BPO delivery centers (e.g., Philippines, Eastern Europe, Latin America, and China),



and could pose a threat to India's continued dominance of the space. These locations also offer lower cost than source geographies, provide sizeable pools of talent, and offer valuable leverage points to buyers. Further, these competing destinations are continuing to reshape their fiscal and regulatory incentive structures to attract buyers as well as providers of BPO services.

The economic model behind India's BPO industry is constantly changing. Historically, providers have been able to tap into relative wage differentials across geographies to build a strong value proposition for offshoring. While cost-arbitrage continues to be a significant driver of global sourcing for most buyers, the associated benefits will diminish over time with changes in underlying factors. Adverse currency movements and wage inflation in India are putting pressure on operating margins of providers. Compared to the US dollar, the Indian currency appreciated significantly since 2002 – a trend that is likely to continue in the near term and even in the medium to long-term. Inflationary pressures on operating cost are unlikely to ease, due to resource scarcity and overall economic growth. Scenarios on potential momentum indicate that cost-arbitrage can diminish in the medium-term. As a result, reliance on a cost-savings-driven value proposition alone will not be in the best long-term interest of the Indian BPO industry.

Given this environment, two broad priorities emerge for the industry: a) optimize the current environment in order to continue the cost-arbitrage-led proposition, and b) innovate to continue building new, higher-value propositions for buyers.

Evolving buyer expectations also drive the necessity to deliver additional value beyond labour arbitrage. With increasing maturity, buyers are looking for impact beyond costs and efficiency. Mature buyers are adopting optimization and transformation-focussed objectives. Evolving buyer expectations are also reflected in buyers' third-party vendor selection criteria – in addition to cost- and quality-related criteria, process expertise, industry expertise, and strategic impact today figure as key vendor selection criteria for mature buyers. Similarly, captives are also facing growing expectations from their parent companies, with more than 70 percent of parent companies expecting captive operations to deliver value beyond cost savings.

Fulfilling these expectations will require that providers make specific choices and trade-offs in terms of capabilities and investments. Providers will need to develop value-add approaches in terms of the type of work (move from providing simple rules-based work to complex judgment-based work), type of capability (develop standards and centers of excellence) and accountability for outcome (move from ownership of task to ownership of process and business outcome). There is early evidence of providers stepping-up to deliver such initiatives and value-add results to buyers.

Successful outcomes will be reflected in terms of broad adoption of future-state provider models and changes in the way buyers pursue global sourcing opportunities. Increasingly, buyers will need to approach global sourcing issues with a transformational mindset while deciding on a) sourcing models,

b) engagement and governance approaches with providers, and c) developing output-based pricing / performance metrics.

As providers step up, arbitrage-centric, sub-scale operations will come under pressure. Most players will need to invest in highly specialized offerings or diversify to build scale. Industry dynamics suggest four kinds of end-state models for third-party vendors:

1. **Global leader** - large integrated, full-service BPO player offering end-to-end service delivery in multiple segments (across multiple key verticals and most horizontals). These vendors will have global delivery capabilities including a fairly large onshore delivery presence and will deliver true transformational services to large and mid-size buyers, and will act as value-adding innovation partners.
2. **BPO specialist** - provide best-in-class BPO services for priority verticals and horizontals. These vendors will have distinctive offerings based on domain expertise and superior transition capabilities. They will service transformation-focused as well as optimization-focused buyers that are willing to offshore core as well as non-core processes.
3. **Diversified BPO player** - provider of large number of undifferentiated BPO services for priority verticals and horizontals. These vendors will provide end-to-end services for a small number of key domains and be 'strategically opportunistic' in service delivery across other domains.
4. **Segment specialist** - provide end-to-end services for 1-2 key domains (verticals or horizontals). These vendors will develop as large specialized players with significant global expertise in select domains and will service specific core skills not addressed by other providers.

Similarly, three potential end-state alternatives will emerge for captives, each requiring appropriate operational trade-offs across capability building, metrics, organization structures, and decision-making processes:

1. **Global center of excellence** - drive excellence / improvement theme(s) in global context, provide end-to-end ownership of process and alignment with parent on business and strategic objectives. These organizations will develop based on deep domain experience in high-value horizontal or vertical processes and will increasingly create solutions for the parent company versus simply delivering services.
2. **Innovation incubator** - drive innovation at a global company level and develop based on significant investment in cutting-edge tools, technologies, and platforms.
3. **Low-cost aggregator** - develop as cost-competitive, scaled organization operating within internal marketplace (combination of third-party vendors and other captive locations).

Key action themes for the future

Over the next five years, right choices by stakeholders of the Indian BPO industry could effect a fivefold growth. There is, however, a need for concerted and collaborative action by various stakeholders to create the enabling 'eco-system' for future growth of the industry.

Efforts are required across eight action themes for the industry to realize its potential and to maintain and accelerate its growth trajectory over the next five to ten years:

1. Protect India's cost advantage to ensure that buyer interest, adoption and growth are sustained

Multiple levers can be used to protect Indian BPO industry's cost-advantage. As a first step, providers need to diversify their delivery footprint within India through creative and innovative operating models. Movement to low-cost Tier- 2/3 cities is attractive despite lower employability and higher management overheads. Our analysis shows that providers can reduce total operating costs by 20-30 percent by moving to a low-cost city within India. By doing this, the industry can effectively tap labour pools in several states across India.

In addition, providers will need to increase focus on cost rationalization and revenue de-risking initiatives. These could involve initiatives to 1) increase resource utilization, 2) manage wage cost increases, 3) optimize internal SG&A expenses, and 4) de-risk revenue stream by diversifying the client base and adopting currency hedging strategies.

The Government also needs to maintain support to the industry through appropriate incentives and facilitate creation of infrastructure to ensure parity with other competing nations. These incentives and support mechanisms could include fiscal incentives (e.g., continuation of the tax benefits under the STPI scheme beyond 2009, stamp duty exemptions), infrastructure incentives (e.g., build infrastructure capacity ahead of demand in Tier- 2/3 cities through incentives to direct and indirect participants and increased public-private partnerships) or even changes to labour laws, promotion of SMEs¹², and removal of some key telecom-related restrictions.

2. Create 'BPO hubs' with the enabling physical and social 'eco-system' to drive BPO-led growth broader and deeper within India

Government and industry will need to collaborate to facilitate creation of BPO hubs in Tier- 2/3 cities within India. Creation of BPO hubs is dependent on creation of an enabling eco-system required to successfully operate in Tier- 2/3 cities. This eco-system should include elements of physical (e.g., international connectivity, mass-transport system, telecom connectivity, power, housing) as well as social (e.g., healthcare, education, shopping and entertainment, security, hotels) infrastructure. Further, there may be an opportunity to shape the creation of infrastructure in a way that it is based on skill availability and the domestic industry footprint within each BPO hub.

¹²Small and medium enterprises

3. Increase employability and access untapped talent pools by creating greater linkages between the current education system and the needs of the BPO industry, and facilitating the development of BPO-specific education models

Initiatives related to education are required to expand the employable talent pool in India. The industry needs to work more aggressively with the Government to create greater linkage between the current education system and requirements of the BPO industry. This can be done by 1) policy changes like liberalization of higher education, 2) increased collaboration between industry and academic institutions to take up initiatives such as introduction of BPO-specific curriculum and improving students' access to funds for higher studies, 3) introducing coursework changes and teacher training at the school level in accordance with future requirements of the BPO industry. There is also a significant opportunity for private players to step in and create a BPO education industry. Such a move should be based on creating longer-term training programs to improve communication and other skills required by the BPO industry. Specific training programs need to be developed to create several intermediate levels of skills and specialization (between generalists and highly trained specialists), and to bring alternate talent pools (e.g., highschool graduates, educated housewives) into the BPO workforce.

4. Encourage the growth of domestic BPO market to enhance the competitiveness of Indian industry, create additional employment, and facilitate development

In order to facilitate growth of the domestic BPO market, specific regulatory barriers (e.g., cap on domestic operations that can be handled from an existing center used for export businesses) need to be removed. In addition, the value proposition of domestic BPO needs to be crystallised and communicated to the buyer community to enable widespread adoption. To be successful in the domestic market, providers will need to develop an end-to-end value proposition and adopt innovative delivery strategies.

5. 'Up-shift' the third-party and captive value proposition to effectively deliver against changing buyer expectations

Providers will need to step up to fulfill evolving buyer expectations regarding optimization and transformational value creation. Our extensive interaction with buyers indicates that one of the key initiatives required would be providers engaging with buyers early in the decision-making process. Providers need to become a part of the decision-making process by developing consulting capabilities, creating strategic account-management capabilities, and tailoring their value proposition based on buyer maturity and requirements. Providers will also need to create an improved value-added approach by investing in people, process, and technology-related initiatives. The final aspect of up-shifting the value proposition would be for buyers and providers to create win-win economics by adopting pricing metrics related to process output or business drivers and linking them to business performance metrics. Such a move will incentivize providers to develop into value adding partners.

6. Shape an 'integrator' role for the Indian BPO industry in the emerging global services supply chain

As large, mature buyer organizations push offshoring lever harder, a global services supply chain is emerging. There are many examples of multi-location global sourcing networks created through use of captives and third-party vendors. While India is often the nerve center of such networks, other offshore locations offer unique advantages that may not be replicable in India (e.g., Philippines has superior English language and soft skills for customer service operations especially for US buyers, Eastern Europe offers language and time-zone advantages for European buyers). The Indian BPO industry, therefore, needs to aggressively take on a more proactive and shaping role in the global sourcing space. Providers need to continue to expand their delivery network to other low-cost geographies to take advantage of the leverage points offered by these destinations and expand their service delivery footprint onshore to take end-to-end ownership of service delivery. Providers could also identify opportunities to create alliances (mergers, acquisitions, subcontracting) with overseas players to develop compelling propositions for buyers. The industry should collaborate and develop alliances with industry bodies in other competing destinations in order to create an enabling environment for acquiring specialized skills from other emerging locations (e.g., European language skills from providers in Eastern Europe).

7. Communicate the true performance and potential of the industry to a broader set of stakeholders, including buyers, employees and Government

The Indian BPO industry needs to clearly communicate its value proposition to buyers, current and potential employees, influencers, and Government. Specific outreach programs need to be implemented to increase interaction with buyers in order to highlight the growing maturity of service offerings and provide perspectives on perceptions regarding political, economic and social risks. The industry should also partner actively with media to facilitate greater and more balanced communication to the external world through proactive coverage of achievements and potential of the BPO industry. Current and future employees, as well as influencers such as parents of young graduates, form a very critical group of stakeholders for the BPO industry. Individual providers as well as the industry need to promote the attractiveness of BPO as a career option by highlighting exceptional firm-level initiatives for employee development and facilitating information-exchange forums / mass outreach programs at various colleges.

8. Help buyers embrace the overall opportunity of India's BPO industry in a more meaningful way

Buyer organizations will need to re-orient their global sourcing decision-making process in order to tap the significant opportunity presented by the Indian BPO industry. They need to adopt a more holistic view of global sourcing opportunities, engage a larger internal stakeholder group, and develop a comprehensive global sourcing plan along with an enabling organization model. In addition, buyers also need to develop sourcing and engagement models with providers that foster integration, optimization and innovation.

The traditional notion of what Business Process Offshoring could deliver for buyers is gradually giving way to a transformation-driven outlook. These changes present significant opportunities for the Indian BPO industry but, at the same time, also necessitate conscious decision-making by all stakeholders. We believe that the eight key action themes outlined in this report will enable the Indian BPO industry to ride the next wave of growth. However, effective implementation will require continuous collaboration between key stakeholders in the industry, including the Government.

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